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THESIS

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AN EXAMINATION OF FORWARD PRICING RATE
AGREEMENTS (FPRA'S) AT DCASPRO'S
AND NAVPRO'S

by

James S. Town

June 1988

Thesis Advisor:

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88 12 6 013

UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE

REPORT DOCUMENTATION PAGE

1a REPORT SECURITY CLASSIFICATION UNCLASSIFIED			1b RESTRICTIVE MARKINGS		
2a SECURITY CLASSIFICATION AUTHORITY			3 DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release; distribution is unlimited		
2b DECLASSIFICATION/DOWNGRADING SCHEDULE					
4 PERFORMING ORGANIZATION REPORT NUMBER(S)			5 MONITORING ORGANIZATION REPORT NUMBER(S)		
6a NAME OF PERFORMING ORGANIZATION Naval Postgraduate School		6b OFFICE SYMBOL (If applicable) Code 54	7a NAME OF MONITORING ORGANIZATION Naval Postgraduate School		
6c ADDRESS (City, State, and ZIP Code) Monterey, California 93943-5000			7b ADDRESS (City, State, and ZIP Code) Monterey, California 93943-5000		
8a NAME OF FUNDING SPONSORING ORGANIZATION		8b OFFICE SYMBOL (If applicable)	9 PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER		
8c ADDRESS (City, State, and ZIP Code)			10 SOURCE OF FUNDING NUMBERS		
			PROGRAM ELEMENT NO	PROJECT NO	TASK NO
			WORK UNIT ACCESSION NO		
11 TITLE (Include Security Classification) AN EXAMINATION OF FORWARD PRICING RATE AGREEMENTS (FPRA'S) AT DCASPRO'S AND NAVPRO'S					
12 PERSONAL AUTHOR(S) Town, James S.					
13a TYPE OF REPORT Master's Thesis		13b TIME COVERED FROM _____ TO _____		14 DATE OF REPORT (Year, Month, Day) 1988, June	
15 PAGE COUNT 87					
16 SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.					
17 COSATI CODES			18 SUBJECT TERMS (Continue on reverse if necessary and identify by block number)		
FIELD	GROUP	SUB-GROUP	Forward Pricing Rate Agreement (FPRA); Contract Administration; Plant Representative Offices		
19 ABSTRACT (Continue on reverse if necessary and identify by block number) The purpose of this thesis is to determine the extent to which Forward Pricing Rate Agreements (FPRA's) have been established at Defense Contract Administration Services Plant Representative Offices (DCASPRO's) and Naval Plant Representative Offices (NAVPRO's). The research is also intended to identify the reasons why FPRA's are not established and determine what actions can be taken to increase the number of this type of agreement. The major conclusion is that Forward Pricing Rate Agreements covering the main categories of labor and overhead rates have not been established to the maximum extent possible at DCASPRO's and NAVPRO's. The primary recommendation is to eliminate the requirement to use the Joint Logistics Commanders' (JLC) uniform rates of change when determining forward pricing rates for executive compensation, salaries, wages and employee benefits. (KR) ←					
20 DISTRIBUTION/AVAILABILITY OF ABSTRACT <input checked="" type="checkbox"/> UNCLASSIFIED/UNLIMITED <input type="checkbox"/> SAME AS RPT <input type="checkbox"/> DTIC USERS			21 ABSTRACT SECURITY CLASSIFICATION Unclassified		
22a NAME OF RESPONSIBLE INDIVIDUAL LCDR Raymond W. Smith			22b TELEPHONE (Include Area Code) (408) 646-2052		22c OFFICE SYMBOL Code 54Sx

DD FORM 1473, 84 MAR

83 APR edition may be used until exhausted

All other editions are obsolete

SECURITY CLASSIFICATION OF THIS PAGE

U.S. Government Printing Office: 1988-400-242

UNCLASSIFIED

Approved for public release; distribution is unlimited

An Examination of Forward Pricing Rate Agreements (FPRA's)
At DCASPRO's and NAVPRO's

by

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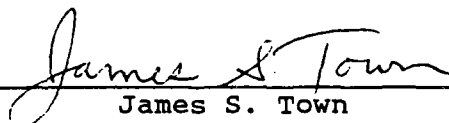
Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
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ABSTRACT

The purpose of this thesis is to determine the extent to which Forward Pricing Rate Agreements (FPRA's) have been established at Defense Contract Administration Services Plant Representative Offices (DCASPRO's) and Naval Plant Representative Offices (NAVPRO's). The research is also intended to identify the reasons why FPRA's are not established and determine what actions can be taken to increase the number of this type of agreement. The major conclusion is that Forward Pricing Rate Agreements covering the main categories of labor and overhead rates have not been established to the maximum extent possible at DCASPRO's and NAVPRO's. The primary recommendation is to eliminate the requirement to use the Joint Logistics Commanders' (JLC) uniform rates of change when determining forward pricing rates for executive compensation, salaries, wages and employee benefits.



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I. INTRODUCTION

A. BACKGROUND

Forward pricing rates are rates and factors, such as direct labor rates, various overhead rates, and cost-of-money factors that are used by contractors in pricing proposals for new procurement or modifications to existing contracts. Contractors may formalize these rates with the Government through a negotiated written agreement called a Forward Pricing Rate Agreement (FPRA). FPRA's make the rates and factors available for a specified period of time and are particularly beneficial to those contractors who do a large amount of pricing actions. Although FPRA's can be very useful, there has been reluctance on the part of some contractors to enter into these agreements. [Refs. 1:p. 15-26; 2:p. 69]

B. OBJECTIVE

The purpose of this thesis is to determine the extent to which Forward Pricing Rate Agreements (FPRA's) have been established at Defense Contract Administration Services Plant Representative Offices (DCASPRO's) and Naval Plant Representative Offices (NAVPRO's). The thesis is also intended to identify the reasons why FPRA's are not established and determine what actions can be taken to increase the number of this type of agreement.

Specific objectives of the thesis are as follows:

1. Explain the FPRA process.
2. Determine the extent to which FPRA's have been established at DCASPRO's and NAVPRO's and identify the reasons why FPRA's are not entered into.
3. Identify the advantages and disadvantages of FPRA's.
4. Determine what actions can be taken to increase the number of FPRA's.

C. RESEARCH QUESTIONS

The primary research question is:

To what extent have Forward Pricing Rate Agreements (FPRA's) been established at DCASPRO's and NAVPRO's?

Subsidiary research questions are:

1. What are the reasons (Government and contractor), that FPRA's are not established?
2. To what extent and for what reasons are FPRA's abrogated (canceled) by either party prior to the expiration of the agreement?
3. What actions can be taken (Government, contractor and statutory/regulatory) to increase the number of FPRA's?

D. RESEARCH METHODOLOGY

The research methodology employed in this thesis included a comprehensive literature review and personal interviews. The comprehensive literature review involved a review of current periodicals, previous research reports, Federal statutes, Federal procurement regulations and manuals, Boards of Contract Appeals decisions, U.S. Court of Claims decisions and decisions of the Comptroller General. The reviews of the Boards of Contract Appeals decisions,

U.S. Court of Claims decisions and decisions of the Comptroller General were conducted with the assistance of Federal Legal Information Through Electronics (FLITE).

Personal interviews were conducted with DCASPRO, NAVPRO and contractor personnel. Selected DCASPRO and NAVPRO personnel were asked to respond to an 11 question survey. The survey consisted of seven primary questions and four subsidiary questions. A listing of these questions is contained in the next section of this chapter.

The examination of FPRA's in this thesis was limited to DCASPRO's and NAVPRO's for two reasons. First, Plant Representative Offices were chosen because these commands would not have been established if the cognizant contractor did not do a high volume of Department of Defense contracting. Secondly, DCASPRO's and NAVPRO's were selected because of the probability that these activities will handle some or all Navy contracts.

A sample of 20 DCASPRO's (43 percent) and 8 NAVPRO's (53 percent) of the present total population of 47 DCASPRO's and 15 NAVPRO's was selected for the survey. The selection process was not scientific; however, it was designed to provide a representative sample of DCASPRO's and NAVPRO's. Two DCASPRO's were selected from each of the nine regions with the exception of the St. Louis, New York and Los Angeles regions. Due to the large number of PRO's located in the New York and Los Angeles regions three and four

PRO's, respectively, were selected. The only PRO assigned to the St. Louis region was selected. The eight NAVPRO's were also selected based on geographic location. Two were selected from the East Coast, three were selected from the Midwest, and three were selected from the West Coast.

The survey questions were presented to Contract Management Branch Chiefs, Financial Services Branch Chiefs, Business Management Branch Chiefs, Corporate Administrative Contracting Officers (CACO), Divisional Administrative Contracting Officers (DACO) and Cost Monitoring Coordinators (CMC). The interviews were conducted either at the Plant Representative Office or via telephone. Each interview lasted an average of 20 minutes.

E. SURVEY QUESTIONS

1. Primary Questions

The seven primary questions asked in the survey were:

1. Does your Plant Representative Office currently have any Forward Pricing Rate Agreements?
2. Has your office had any FPRA's within the previous five years (calendar years 1983-1987)?
3. What do you feel are the main advantages of FPRA's?
4. What do you feel are the main disadvantages of FPRA's?
5. What actions can be taken by DCASPRO's/NAVPRO's to increase the number of FPRA's?
6. What actions can be taken by Government contractors to increase the number of FPRA's?

7. What statutory or regulatory changes could be made that would lead to an increase in the number of FPRA's?

2. Subsidiary Questions

The four subsidiary questions asked were:

1. What is the time period of coverage for the agreement(s)?--This question was asked of those respondents who answered "Yes" to Question One.
2. What are the reasons for not having any agreements?--This question was asked of those respondents who answered "No" to Question One.
3. Were any of the prior agreements abrogated and if so, for what reason or reasons?--This question was asked of those respondents who answered "Yes" to Question Two.
4. What were the reason or reasons for not entering into any FPRA's?--This question was asked of those respondents who answered "No" to Question Two.

F. ASSUMPTIONS AND SCOPE

1. Assumptions

The assumption made at the beginning of the thesis process was that forward pricing rate agreements are a useful contracting tool. It was also assumed that there has been reluctance on the part of some contractors to enter into these agreements.

Additionally, although only 43 percent of the DCASPRO's and 53 percent of the NAVPRO's were actually surveyed it is assumed that the data gathered from these activities accurately reflect the total population.

2. Scope

The primary research question concerning establishment of FPRA's at DCASPRO's and NAVPRO's largely defined the scope of the thesis.

G. ORGANIZATION OF STUDY

The thesis is divided into five chapters. Chapter I addresses the objective of the thesis and includes research questions; research methodology; survey questions; scope and assumptions; and organization of the study.

Chapter II provides background information and a general description of the FPRA process.

Chapter III reports the results of the surveys that were conducted with DCASPRO and NAVPRO personnel.

Chapter IV analyzes the results of the surveys as reported in Chapter III.

Chapter V contains the researcher's conclusions derived from data analysis as presented in Chapter IV. It also includes recommendations for improving the FPRA process and lists areas of possible future research on this topic.

II. BACKGROUND

A. INTRODUCTION

Chapter II will provide background information and a general description of the FPRA process. Current regulations and directives governing FPRA's (FAR, DFARS, DLAM, ASPM) will be synopsized and pertinent protests and appeals will be summarized. There is also discussion of FPRA-related issues. The chapter will conclude with an example of a typical forward pricing rate cycle and outline the process and procedures required to establish an FPRA.

B. FEDERAL ACQUISITION REGULATION (FAR)

Federal Acquisition Regulation (FAR) section 15.809 contains the current Federal regulations governing FPRA's. The FAR defines a forward pricing rate agreement as [Ref. 1: p. 15-26]:

...a written agreement negotiated between a contractor and the Government to make certain rates available during a specified period for use in pricing contracts or modifications. Such rates represent reasonable projections of specific costs that are not easily estimated for, identified with, or generated by a specific contract, contract end item, or task. These projections may include rates for labor, indirect costs, material obsolescence and usage, spare parts provisioning, and material handling.

FPRA's "may be requested by the contracting officer or contractor or initiated by the Administrative Contracting Officer (ACO)" but "should be negotiated only with

contractors having a significant volume of government contract proposals." The decision on establishment of an FPRA rests with the cognizant contract administration agency. In making the decision on FPRA's the ACO should consider "whether the benefits to be derived from an agreement are commensurate with the effort of establishing and monitoring it." [Ref. 1:p. 15-39]

The FAR lists three requirements that shall be addressed in every FPRA.

1. An agreement is required to "provide specific terms and conditions covering expiration, application, and data requirements." The purpose of this is to allow for "systematic monitoring" in order to "assure the validity" of the forward pricing rates.
2. The FPRA must also provide for cancellation. A cancellation may be done by either party.
3. The third item that must be addressed is the requirement that any significant changes to the contractor's cost or pricing data be submitted to the ACO and cognizant contract auditor. This action permits the rates to be properly monitored and allows for adjustment or abrogation of the agreement. [Ref. 1:p. 15-39]

Establishment and usage of FPRA's require specific actions on the part of ACO's, government contractors (offerors) and contracting officers. The responsibilities of each, as delineated in the FAR, are contained in the following paragraphs.

1. Administrative Contracting Officer (ACO)

It is the ACO's responsibility to obtain a contractor's proposal. The proposal must contain current, accurate, and complete cost and pricing data as of the date

of submission. The ACO then evaluates the proposal, develops a Government objective and conducts negotiations with the contractor. The ACO is required by FAR to invite "the cognizant contract auditor and contracting offices having a significant interest to participate" in the above processes. The ACO "shall prepare a Price Negotiation Memorandum (PNM)" upon completion of the negotiations. The ACO must also forward copies of both the FPRA and PNM to "all known contracting offices" that may be affected by the FPRA and "to the cognizant auditor." [Ref. 1:p. 15-39]

A certificate of current cost or pricing data is not required at the time of establishment of the FPRA. [Ref. 1: p. 15-39]. If the FPRA is used to support a later contractual action that requires a certificate of current cost or pricing data, the certificate shall cover the following [Ref. 1:p. 15-30]:

...(1) the data originally supplied to support the forward pricing rate agreement or other advance agreement and (2) all data required to update the price proposal to the time of agreement on contract price.

The ACO is also responsible for determining whether or not changed conditions have invalidated all or part of the FPRA. If the agreement is determined to be invalid by the ACO due to changed conditions, the ACO "shall notify all interested parties of the extent of its effect and initiate revision of the agreement." When invalidated "the contractor, ACO, and contracting officer shall reflect the changed condition in proposals, cost analyses, and

negotiations, pending revision of the agreement." [Ref. 1: p. 15-39]

2. Government Contractors

The FAR prescribes two requirements for government contractors. Contractors, termed "offerors" in the FAR, are required to: (1) "describe any FPRA's in each specific pricing proposal to which the rates apply" and (2) "identify the latest cost or pricing data already submitted in accordance with the agreement." [Ref. 1:p. 15-39]

3. Contracting Officer

In accordance with FAR, a contracting officer will "use FPRA rates as bases for pricing all contracts, modifications, and other contractual actions" that will be "performed during the period covered by the agreement." The only exception to this requirement occurs when "the ACO determines that changed conditions have invalidated part or all of the agreement." The contracting officer is also required to promptly report to the ACO any condition that may effect the FPRA's validity. [Ref. 1:p. 15-39]

C. DEPARTMENT OF DEFENSE FAR SUPPLEMENT (DFARS)

The Department of Defense FAR Supplement (DFARS), section 15.809, provides additional Department of Defense requirements concerning FPRA's. The section focuses primarily on changed conditions. Subsection 15.809 (e) (2) provides the following list of items that the Department of

Defense (DOD) requires an ACO to consider in assessing changed conditions [Ref. 3:p. 15.8-14]:

(i) the type of contract contemplated; (ii) whether the dollar amount of the proposed contract action would significantly change the rates in the agreement; (iii) whether the performance period of the proposed contract action is significantly different from the period to which the rate agreement applies; and (iv) any new data or other information that may raise a question as to the acceptability of the rates.

The DFARS also states that contracting representatives should not delay individual contracting actions when changed conditions negate FPRA's. [Ref. 3:p. 15.8-14]

D. DEFENSE LOGISTICS AGENCY MANUAL 8105.1 (DLAM 8105.1)

The Defense Logistics Agency's Contract Administration Manual for Contract Administration Services (DLAM 8105.1) specifically defines the procedures for establishing FPRA's. DCASPRO's are required to follow these procedures.

As stated in Section II.B.1. above, the first step in this process is the ACO's request for, and contractor's submission of, an FPRA proposal. The request should be timely enough to allow for contractor preparation, Government review and negotiations prior to the beginning of the period that the FPRA is intended to cover. The ACO should normally request the contractor's proposal at least six months prior to the beginning of the applicable period. [Ref. 2:p. 69]

The proposal, which should normally cover all fiscal periods for which the rates and factors will be required,

should be thorough enough to support the following 19 budget estimates [Ref. 2:pp. 69,70]:

1. Projections or assumptions supporting the sales forecast (including identification of potential buyers, e.g., specific Government buying activities, foreign military sales and commercial sales).
2. Planned production scheduling, planned engineering projects, projected material usage, and product delivery assumptions.
3. Projected major indirect expenses which make up the proposed overhead expense pool or cost center expenditures.
4. Projected base(s) used to allocate the indirect costs.
5. Major planned capital expenditures including plant expansion.
6. Pending corporate structure changes, i.e., mergers or divestitures.
7. Changes or inconsistencies with previously disclosed methods of allocating costs to the overhead pools or cost centers.
8. Plant or equipment renovation plans.
9. Plans for disposition of idle facilities or idle capacity.
10. Increases in direct and indirect labor rates.
11. Anticipated changes in fringe benefits.
12. Impact on labor costs resulting from changes in labor skill mix.
13. Equivalent number of employees expected to be charged to overhead, forecast by time period, function and location.
14. Equivalent number of employees expected to be charged direct to contracts, forecast by time period, function, and location.
15. Planned efficiencies which affect costs.

16. Economic factors and conditions that are reasonably expected to exist at specified future periods.
17. Pricing factors used for travel, material handling, spoilage, etc.
18. Ratio of indirect labor costs to direct labor costs.
19. Any specific item, area, or function within the proposal that the ACO determines should be explained or expanded.

The next procedure involves the government's review of the contractor's FPRA proposal. This review will consist of pricing, technical and audit evaluations. The pricing report will be conducted by the Cost Monitoring Coordinator (CMC) or price analyst upon request by the ACO and will include the technical and audit reports. The pricing report will focus on inefficiencies or unallowable costs and comment on the validity of the contractor's projected sales volume. Estimates of Independent Research and Development (IR&D) and Bid and Proposal (B&P) costs will also be obtained and reviewed. The technical review will examine the contractor's anticipated labor and material requirements for the period covered by the FPRA. [Ref. 2:p. 70]

The third step in establishing an FPRA involves the negotiations between government and contractor representatives. As stated previously, procuring activities having significant business with the contractor will be invited, in writing, by the ACO to participate in the negotiation of the agreement. [Ref. 2:p. 70]

When an agreement is reached on forward pricing rates it will be formalized in a written document and executed by the contractor and ACO. An FPRA negotiation memorandum describing the pertinent events and considerations will be drafted by the ACO to support the agreement. A copy of this memorandum and the proposed FPRA are then forwarded to the cognizant Defense Contract Administration Services Region (DCASR) for review of "reasonableness and propriety" by the DCASR review board. [Ref. 2:pp. 70,71]

The final step in the process involves furnishing a copy of the executed FPRA to all negotiation participants and Procurement Contracting Officers (PCO's) having repetitive business with the contractor. [Ref. 2:p. 71]

E. ARMED SERVICES PRICING MANUAL (ASPM)

The Armed Services Pricing Manual (ASPM) comments briefly on FPRA's. Under the section on interim pricing, the manual addresses forward pricing factors. It classifies these factors, along with overhead rates, as administrative pricing actions. The ASPM lists certain considerations that ACO's should consider in their decision to use or not use FPRA's. Those considerations are as follows:

1. What is the volume of pricing actions?
2. Are all government agencies doing significant business with the government in agreement on the rates?
3. Is the period of the agreement "long enough to justify the administrative effort but not so long as to create an unacceptable risk?"

4. What will "the nature, type and diversity of operations and product mix bear on the terms of the agreement?"
5. What is the reliability of cost accounting data and cost estimating procedures? [Ref. 4:pp. 10-9,10-10]

The manual then highlights particular items an ACO should watch for while monitoring the agreement such as: (1) "changes in business volume," (2) "changes in market conditions affecting material or labor costs," (3) "savings accruing from cost reduction programs," and (4) "changes in the accounting treatment of direct and indirect costs." [Ref. 4:p. 10-10]

F. PROTESTS

1. Introduction

A search of unpublished Decisions of the Comptroller General covering the period of January 1955 through March 1987 conducted by Federal Legal Information Through Electronics (FLITE) identified two protests that were directly related to forward pricing rate agreements. The two protests were against the same contract award.

2. Protests B-219428, B-219440

a. Overview

The protests (B-219428, B-219440, October 17, 1985, 85-2 CPD 416), centered on the Naval Sea Systems Command's (NAVSEA) proposed award of a contract based on evaluation of costs through the use of current audited forward pricing rates from existing agreements vice through

the use of a Defense Contract Audit Agency (DCAA) audit of proposed costs. The two protests were handled as one by the General Accounting Office (GAO).

b. Background

On March 26, 1985 NAVSEA issued a Request For Proposals (RFP) No. N00024-85-R-8511 for the Atlantic Fleet AE-class phased maintenance program. The solicitation was a total small business set aside geographically restricted to the Earle, New Jersey homeport area. The RFP called for an award fee contract and stated that each proposal would be evaluated on (listed in descending order of importance), management capability, cost, technical approach and resource availability. NAVSEA also stated in the solicitation that the Government reserved the right to award on the basis of initial proposals without holding discussions. [Ref. 5]

Four ship repair facilities submitted proposals in response to the RFP. NAVSEA initially asked DCAA to prepare an audit report on the cost portion of the four proposals but subsequently canceled the request when it was discovered that relevant rate information was available from the Supervisor of Shipbuilding, Conversion and Repair, United States Navy, Brooklyn (SUPSHIP Brooklyn). SUPSHIP Brooklyn provided NAVSEA with each contractor's current audited forward pricing rates and these rates were then used in the proposal evaluations to determine the "cost to the Government". [Ref. 5]

After weights were assigned to each evaluation category, Coastal Dry Dock and Repair Corporation (COASTAL) received the highest number of points in each of the technical categories and the highest number of points overall. COASTAL was not the lowest cost offeror however, their cost was determined to be fair and reasonable. [Ref. 5]

COASTAL, based on their "overall highest score, superior technical scores and reasonable valuated projected cost," was recommended to the source selection authority by the PCO for selection as the successful offeror. No discussions were held with the three other offerors. On June 28, 1985 the unsuccessful offerors were notified of the proposed award to COASTAL. Hoboken Shipyards, Inc. (Hoboken) and Perth Amboy Dry Dock Company (Perth Amboy) then filed individual protests with GAO. [Ref. 5]

c. Protested Items

The following eight items were protested by Perth Amboy and/or Hoboken:

1. Combination of three overhauls in one contract.
2. DCAA audits were not completed nor considered in the cost analysis.
3. Award of the contract without full consideration of the cost realism requirements.
4. Award without discussions.
5. Insufficient time allowed for cost evaluation.
6. Bias in evaluation.

7. Qualifications of proposed awardee to perform the contract.

8. Recovery of proposal preparation and protest costs.

All protests were either dismissed or denied by GAO. [Ref. 5]

d. GAO's Decisions

The use of forward pricing rates was a major issue in two of the protested items listed in Section II.F.2.b. above. Concerning item (2) (DCAA audits were not completed nor considered in the cost analysis), GAO found that

...neither protester has shown that the contracting officer's decision to use forward pricing rates...to assist in determining 'cost to the Government' was clearly erroneous, and we find nothing improper in this approach. [Ref. 5]

The findings on item (3) (Award of the contract without full consideration of the cost realism requirements), are a clear indication of GAO's support for the use of current, audited forward pricing rates in proposal cost evaluations. The following statements were extracted from GAO's decision on this protested item [Ref. 5]:

1. It was reasonable for the Navy to use forward pricing data provided by SUPSHIP Brooklyn to formulate labor rates and overhead rates as elements in the "cost to the Government" evaluation factor score.
2. DOD FAR SUPP 15.805(A)(1)(V), supra, authorizes the use of current forward pricing rate agreements in formulating Government cost estimates.

3. Evaluated costs rather than proposed costs provide a sounder basis for determining the most advantageous cost proposal.
4. We (GAO) find no impropriety in the Navy's use of current audited forward pricing rates for each contractor--in lieu of the labor and overhead rates that DCAA audits would have provided--as an element in the source selections plan's formula for determining "cost to the Government."
5. Since the solicitation did not require DCAA audits nor preclude the use of cost data available outside of the proposal in formulating the "cost to the Government" evaluation factor, we found that the Navy's development of independent "cost to the Government" estimates using current audited forward pricing rates was within the discretion permitted a contracting agency in evaluation cost factors.

3. Requests for Reconsideration

Hoboken and Perth Amboy both filed a Request for Reconsideration with GAO concerning GAO's decisions on their protests. The requests (B-219428.2, B-219440.2, November 21, 1985, 85-2 CPD 582), again asserted that the rates in the FPRA's obtained from SUPSHIP Brooklyn were not relevant and NAVSEA's use of those rates in cost evaluation of the offeror's proposals "constituted prejudicial error." [Ref. 5]

It was GAO's finding that the protesters raised no new facts or legal arguments that were not considered during the original protests and that the requests for reconsideration merely indicated dissatisfaction with GAO's decisions. Both requests for reconsideration were therefore denied. [Ref. 5]

G. APPEALS

1. Introduction

A FLITE search of Boards of Contract Appeals decisions covering the period from July 1956 through October 1986 found six appeals that made mention of FPRA's. Of those six appeals, only one actually concerned forward pricing rate agreements; Dillingham Shipyard ABSCA NO. 27458, November 28, 1983.

2. Dillingham Shipyard

a. Background

Dillingham Shipyard (DSY) filed a timely appeal on the denial of their claim that incurred legal expenses for defective pricing claims on three prior vessel repair contracts should be included as allowable G&A expenditures in forward pricing rate agreements. The appeal related to a contracting officer's "final decision," (dated June 8, 1982), which disallowed inclusion of the legal fees for the defective pricing claims based on DCAA's audit report conclusion that since the expenses were incurred on three previously completed contracts, future Government contracts should not have to bear the costs. Dillingham, on the other hand, argued that the expenses should be allocated to their long term Master Ship Repair (MSR) contract and desired to have the legal costs added to their G&A pool. [Ref. 6:pp. 84605-84607]

Dillingham filed a claim with the contracting officer after DSY and the Navy reached an agreement on forward pricing rates on September 4, 1981 that did not include the \$.10 per hour factor to cover the legal fees. The contracting officer denied the request for the additional \$.10 per hour. DSY then appealed the contracting officer's "final decision" to the Armed Services Board of Contract Appeals (ASBCA). [Ref. 6:pp. 84605-84607]

The Navy argued five points in requesting dismissal of the appeal:

1. "Appellant (DSY) has failed to file a proper claim."
2. "Appellant's 'claim' is not related to the contract."
3. "The board is without jurisdiction to provide the relief requested."
4. "Appellant's 'claim' was not properly submitted to the contracting officer."
5. "The contracting officer did not render a decision on the claims as enunciated in the complaint." [Ref. 6: p. 84608]

Discussion of the Navy's positions listed above will be limited to points (1) and (2) since they are the items pertinent to this thesis.

In their arguments before the ASBCA the Navy asserted that a forward pricing rate agreement is not a contract but [Ref. 6:p. 84609]:

... merely a negotiating tool generated for the administrative convenience of the parties. It binds the parties to nothing. They retain the right to contract at that rate or not to contract at that rate at some time in the future. The agreement does not obligate the

Government to award future contracts. Nor does it bind the contractor to the performance of the future contracts.

It was also argued than an FPRA fails to meet the definition of a "cognizable contract" as defined in section 602 of the Contract Disputes Act. Therefore, if there is not a contract upon which to file a claim, there can be no "claim" and the contracting officer thus had no authority to render a "final decision." The Government also stated that DSY was merely attempting to "increase its pre-negotiation position for future job orders" but is not entitled to such a position as "a matter of right." [Ref. 6:pp. 84608,84609]

The Board agreed with the Navy's assertion that an FPRA is not a contract but a "negotiation tool used at the option of and for the convenience of the parties." However, the Board stated that the fact that an FPRA is not a contract does not resolve whether or not DSY filed a proper claim. The Board commented that the FPRA was an integral element in pricing job orders under the MSR contract, whether the rate was used to price the order or merely as a point to begin negotiations. The Board found that since both parties had elected to use the FPRA as a method of arriving at a price for work performed by Dillingham under the Master Ship Repair contract, arguing that there is an "insufficient nexus between the FPR agreement and subsequent job orders...ignores the facts." [Ref. 6:pp. 84609-84610]

b. Conclusions

The Board concluded that DSY's claim did relate to its contracts and as such constitutes a claim under the Contract Disputes Act. It should also be noted that the Board did not hold that DSY was entitled to the \$.10 per hour for legal fees. The Board also did not hold that they had "any jurisdiction or authority to order the government to include in an FPRA any specific element or any element for legal fees."

The Board did, however, deny the Navy's motion to dismiss based on the finding that DSY's submittal did constitute a claim under the Contract Disputes Act. [Ref. 6:p. 84613]

H. RELATED ISSUES

1. Joint Logistics Commander's (JLC) Uniform rates of Change

The JLC rates of change of 2.5% for 1987, 3.5% for 1988 and 3.5% for 1989 were established by the Joint Logistics Commanders during their 18 June 1987 meeting. The rates of change are for use in the pricing of executive compensation, salaries, wages, and employee benefits. Their purpose is "to be management objectives which provide sufficient motivation to contracting offices to negotiate reasonable cost in establishing contract prices." [Ref. 7]

The policy on the use of JLC rates for DCASPRO's is contained in paragraph 3 of Reference 8:

For evaluating contractor proposed forecasted labor rates, including increases to executive compensation, salaries, wage, and employee benefits, it is the Defense Logistics Agency (DLA) policy to use the lower of either the Data Resources, Inc., (DRI) forecast for Average Hourly Earnings of Production Workers-Private Non-farm or the uniform rates of change recommended by the Joint Logistics Commanders (JLC's).

The JLC uniform rates of change are currently lower than DRI forecasts.

The requirement for the NAVPRO's to use the JLC rates is contained in Reference 7:

Accordingly, Navy contracting officials must continue with efforts previously initiated to negotiate reasonable rates of increase. The pricing of increases to executive compensation, salaries, wages, and employee benefits should not exceed the established rates without adequate justification. Any increases above these recommended management objectives (JLC uniform rates of change) must be sufficiently supported and documented. This rationale and support shall be reviewed and approved by top management in each Command....This position clearly recognizes previously initiated efforts and the established goals within the Government and the current mandate of the Congress to reduce and control DOD spending.

2. Defense Contract Audit Agency (DCAA)

DCAA is a major player in the FPRA proposal review process. It's contribution "is constituted as an advisory report concerning a contractor's financial and accounting policies, practices and experience." [Ref. 2:p. 47] DCAA performs reviews and cost analyses requiring access to a contractor's books and financial records. [Ref. 2:p. 50]

DCAA can be extremely helpful in establishing an FPRA. However, it can also be a hindrance to the process. Personalities and the professional relationship between the

ACO and the auditor are the two main factors which influence whether the auditor is viewed a help or a hindrance. If an auditor takes the approach that the FPRA audit report is "set in concrete" it may become difficult for an ACO to negotiate an agreement. It becomes a case of the Government fighting the Government.

One problem concerning DCAA that was mentioned by several survey respondents was that DCAA uses DRI factors for labor escalation vice the JLC uniform rates of change. DCAA's status as an independent audit agency permits it to use DRI in it's evaluations. A problem arises when its recommendations concerning FPRA labor rates support the contractor's position vice the ACO's position.

3. Forward Pricing Rate Recommendation (FPRR)

Forward Pricing Rate Recommendations (FPRR) are established for administrative convenience when there is a significant number of pricing actions but the contractor is not willing to enter into an FPRA. [Ref. 2:p. 71] The FPRR is a unilateral determination of the rates by the ACO. The rate determination is based on the results of the FPRA proposal review and represent what the ACO feels are fair and reasonable rates. FPRR's are extremely useful when a contractor's rates change frequently. It requires less time and effort to issue an FPRR than it does to establish an FPRA.

FPRR's can simplify contract proposal reviews at the buying commands but these recommended rates may not simplify negotiations. A contractor who is not willing to enter into an FPRA will probably not be willing to use the same Government recommended rates on individual contracts.

It might be to a contractor's advantage to have FPRR's because it is then possible for the contractor to "play one PCO against another." If concessions can be obtained on certain rates from one PCO the contractor can then use these higher rates as a negotiating position when negotiating with other PCO's.

4. Should Cost Review

The purpose of a should cost review is to identify what it should cost to perform work if a "contractor is reasonably efficient and economical in his methods of operation." The review is intended to "identify unecomonical or inefficient practices in the contractor's management or operations" and "lead to both short- and long-range improvements in the contractor's economy and efficiency." It is not the purpose of a should cost review to tell contractors how to conduct their business. [Refs. 1:p. 15-39; 2:p. 73]

The reviews are conducted by a formal team of specialists to "evaluate a contractor's cost projections, supporting standards, and other in-plant management, operational and performance practices on which cost

projections are based." It is a single coordinated effort that merges the review actions of contracting, contract administration, pricing, technical input and audit personnel. [Ref. 2:p. 73]

A should cost review is an extremely productive method for conducting FPRA proposal reviews. It provides the ACO with a thorough examination of a contractors accounting and cost estimating systems. The in-depth knowledge of a contractor's business practices provided by a should cost review enables the ACO to establish FPRA rates that are both fair and reasonable.

5. Defective Pricing

Defective pricing results when a final negotiated contract price based on inaccurate, incomplete or non-current cost or pricing data is agreed upon by the Government and a prime contractor.

In 1962 Congress enacted Public Law (P.L.) 87-653, the Truth-in-Negotiations Act, as an attempt to place Government procurement officials on an "even footing" with contractors during contract negotiations. Section 2306(f) of this law established the requirement for contractors, under certain circumstances, to submit and certify cost or pricing data. The Act also provided for contract adjustment if the data that were submitted were found to be inaccurate, incomplete or noncurrent. Requirements for submitting

certified cost or pricing data are contained in Far section 15.804-2. [Ref. 9:pp. 810-811]

When FPRA rates are used in support of a later contractual action which requires certification, the price proposal certificate should cover the data originally supplied to support the FPRA and all data required to update the price proposal to the time of contract price agreement. Certification for data used to support an FPRA "shall not" be required at the time the FPRA is executed. [Ref. 1:p. 15-30]

Forward pricing rates are normally based on projected future costs, therefore defective pricing is normally not a problem with FPRA's. However, defective pricing issues do arise when the data that were provided to project the rates were inaccurate, incomplete or noncurrent.

I. THE FORWARD PRICING RATE AGREEMENT (FPRA) CYCLE

1. Introduction

The process by which forward pricing rates are initially developed by a contractor and then proposed to and negotiated with the Government is extremely complex. It requires a considerable amount of time and effort on the part of both parties.

Figure 1, discussed below, is an example of a forward pricing rate cycle for one division of a Government contractor. The division is a third tier member of the organization, reporting to a second tier group level which

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
CONTRACTOR- STRATEGIC PLAN		*****	*****	*****	*****							
(DIVISION LEVEL)												
CONTRACTOR- FINANCIAL PLAN						*****	*****	*****				
(DIVISION LEVEL)												
CONTRACTOR- GROUP / CORPORATE								*****	*****			
MANAGEMENT REVIEWS												
CONTRACTOR- BUDGET PREP									*****	*****		
(DIVISION LEVEL)												
CONTRACTOR- BUDGET REVIEW									*****	*****		
(DIVISION LEVEL)												
FINAL BUDGET											*****	
PUBLICATION												
FORWARD PRICING									*****	*****	*****	*****
RATE PREPARATION												
PROPOSED RATES TO PLANT												X
REPRESENTATIVE OFFICE (PRO)												

Figure 1. Forward Pricing Rate Agreement Cycle

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
DCAA RATE REVIEW	*****	*****										
PLANT REPRESENTATIVE OFFICE REVIEW			*****									
CONTRACTOR / PRO NEGOTIATIONS				*****	*****							
FORWARD PRICING RATE AGREEMENT						X						
PRICING RATES PUBLICATION						X						
PRICING RATES BECOME EFFECTIVE							X					
MONTHLY TRACKING ANALYSES	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****
CONTRACTOR PRO REVIEWS	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****

Figure 1. (Continued)

in turn reports to the first tier corporate headquarters. It would be typical for a division of this size to have a Plant Representative Office on-site. Figure 1 outlines the various steps and associated timeperiods that are required to achieve an FPRA.

2. The Forward Pricing Rate Agreement (FPRA) Cycle

As is shown in Figure 1, the FPRA cycle begins approximately 18 months prior to the effective date of the agreement. A brief outline of each of the different steps that occur during this 18 months is contained in the following paragraphs.

a. Strategic Plan

The strategic plan is the first step in the cycle. It is an attempt by the top management personnel within the division to identify and evaluate what market areas will be available during the next ten years and determine at what level the division will be able to participate in those markets. This market evaluation is used to establish a strategy for investment of capital and resources. Management examines where to focus research and development efforts and tries to determine what particular skill levels need to be improved in order for the division to become competitive in targeted markets. The manager's decisions are then formulated into the division's strategic plan. The plan takes approximately four months to produce and a new plan is generated each year.

b. Financial Plan

The financial plan, also developed at the division level, is a zero based budgeting approach to projected future business. The plan normally covers the next three fiscal years with its primary focus on the upcoming fiscal year. The period of coverage of an FPRA is dependent upon the period of coverage of the financial plan. Preparation of the financial plan normally requires about three months and is done annually.

c. Group/Corporate Management Reviews

The third step in the FPRA cycle is a group and corporate headquarters review of both the strategic and financial plans. The review focuses mainly on the financial plan. It is conducted first at the group level and then, after being combined with the plans from the other divisions within the group, is forwarded onto corporate headquarters for final management review and approval. The review process covers a two month period.

d. Division Level Budget

The division level budget is a three step process. First, budget preparation begins while the strategic and financial plans are under headquarters' management review. The budget is specific, addressing items such as the number of jobs, number of hours and costs based on projected sales for the coming fiscal year. This is followed by a local management review of the budget. After

local management approval, the budget is published. The combination of these three steps requires approximately three months of effort.

e. Forward Pricing Rate Preparation

Concurrent with the division level budget preparation forward pricing rates are also being prepared. During this time the data used for budget preparation are being flowed down into the forward pricing rates. Upon publication of the budget the final budget figures are incorporated into forward pricing rates and these rates are then proposed to the Plant Representative Office (PRO). The optimum time for this event to occur is six months prior to the expected effective date of the rates.

The period of coverage for forward pricing rates varies normally from one to five years depending on the contractor and the length of contracts. FPRA's covering more than one year are normally renegotiated annually.

f. DCAA Rate Review

The proposal is then forwarded by the PRO to DCAA for a rate review and corresponding audit report. Two months are allotted to DCAA to conduct their review.

g. Plant Representative Office Review

After receipt of the audit report from DCAA, the PRO commences its review. The review is conducted by the ACO. It consists of an evaluation of the contractor's proposal against Government generated pricing, technical and

audit evaluations. Based on this review the ACO generates a negotiation position. The Government's review of the proposal takes approximately one month.

h. Negotiation and Agreement

Upon completion of the review at the PRO, both Government and contractor representatives enter into negotiations to establish a formal forward pricing rate agreement. When a negotiated settlement is achieved, the forward pricing rate agreement is drafted and executed by both parties. The optimal time for this to occur is approximately 30 days prior to the end of the contractor's fiscal year. This will allow time for the agreement to be reviewed, published and distributed prior to the effective date of the rates. Negotiations require about two months to complete.

i. Monthly Tracking Analyses

The forward pricing rates are tracked continually by both the Government and the contractor. The analyses consist primarily of comparing actual expenditures against budgeted expenditures for each individual overhead cost element. In addition, actual cost inputs are compared to proposed cost inputs. When the difference in an expenditure or cost input would have a material effect on overhead rates, a variance analysis is conducted in order to determine the reason for the difference. [Ref. 2:p. 71]

DLAM 8105.1 establishes a requirement for an in depth government analysis of variances when "baseline targets and actual expenditures are out of tolerance by both three percent and \$100,000 (plus or minus)." [Ref. 2:p. 72]

j. Contractor/Plant Representative Office Reviews

The results of the tracking analyses are reviewed monthly by the contractor and the PRO. The purpose of these reviews is to determine if amendment or cancellation of the FPRA is required.

3. Conclusion

The FPRA cycle provided in Figure 1 is based on an ideal system. In reality the time allotted for the various steps is frequently exceeded and the FPRA's are not negotiated prior to the beginning of the contractor's new fiscal year. When this occurs, the FPRA becomes effective upon the date it is executed. On occasion, and at the concurrence of both parties, outstanding proposals submitted during the current fiscal year but prior to the date of the agreement are repriced using the FPRA rates.

J. SUMMARY

Chapter II provided background information concerning FPRA's. The chapter contained an examination of current laws and regulations governing FPRA's, reviewed pertinent appeals and protests and addressed other issues related to these agreements. The final section of the chapter

presented an example of a typical forward pricing rate cycle.

As was shown in this chapter, the FPRA process is lengthy and complex. A concentrated effort is required by both the Government and the contractor in order to successfully execute an agreement. Chapter III will present data that were derived from the survey of the DCASPRO's and NAVPRO's. The success that DCASPRO's and NAVPRO's have had in establishing agreements will be shown in Chapter III. In addition to examining current and past usage of FPRA's, data will also be provided concerning advantages and disadvantages of the agreements and what actions can be taken to increase the number of FPRA's.

III. SURVEY RESULTS

A. INTRODUCTION

This chapter will present the results of the telephone surveys that were conducted with the 20 DCASPRO's and eight NAVPRO's.

The respondents were each asked seven main questions and two of four subsidiary questions. The answers given for questions one and two determined which two subsidiary questions would be asked. The survey was designed to cover the following three areas: (1) the level of current and past usage of FPRA's by each command, (2) the advantages and disadvantages of FPRA's, and (3) what actions can be taken (Government, industry and statutory/regulatory), to increase the number of FPRA's. An analysis of the data provided in this chapter will be contained in Chapter IV.

B. RESPONSES

1. Overview

There are a multitude of rates that can be covered by a forward pricing rate agreement. One DCASPRO, for example, has agreements covering a total of 129 rates that are in use at six different plant locations. For the purpose of simplification the different rates were grouped into three areas; labor rates, overhead rates and other factors. Other factors are rates such as cost-of-money,

common minor material, special test equipment, travel allowances, etc.

Some DCASPRO's and NAVPRO's are responsible for more than one division or plant location of the company under their cognizance. For those PRO's responsible for more than one division or plant location a separate FPRA is normally established for each. The survey results do not differentiate FPRA usage between the different divisions or plant locations. The data focus only on whether or not an FPRA of any type for any division or location is currently in effect at the DCASPRO or NAVPRO.

FPRA's can be constructed in several different ways. Some activities have one agreement that covers all rates, some have a different agreement for each rate and others group rates together by category or program (e.g., a major weapon system contract) and negotiate an FPRA covering each group. The most common method is to establish a single agreement covering all rates.

2. Question One

Question one was, "Does your Plant Representative Office currently have any Forward Pricing Rate Agreements?"

a. DCASPRO

Of the 20 DCASPRO's that were surveyed, ten (50 percent) currently have FPRA's of some type. Eight DCASPRO's (40 percent) have FPRA's covering the major categories of labor and overhead. Of these eight, seven

have agreements which also include other factors. One DCASPRO (five percent) has an FPRA that covers overhead rates. The agreement does not cover labor rates but does include other factors. One DCASPRO (five percent) has an FPRA that is limited to other factors only. Ten DCASPRO's (50 percent) currently do not have any FPRA's. See Figure 2.

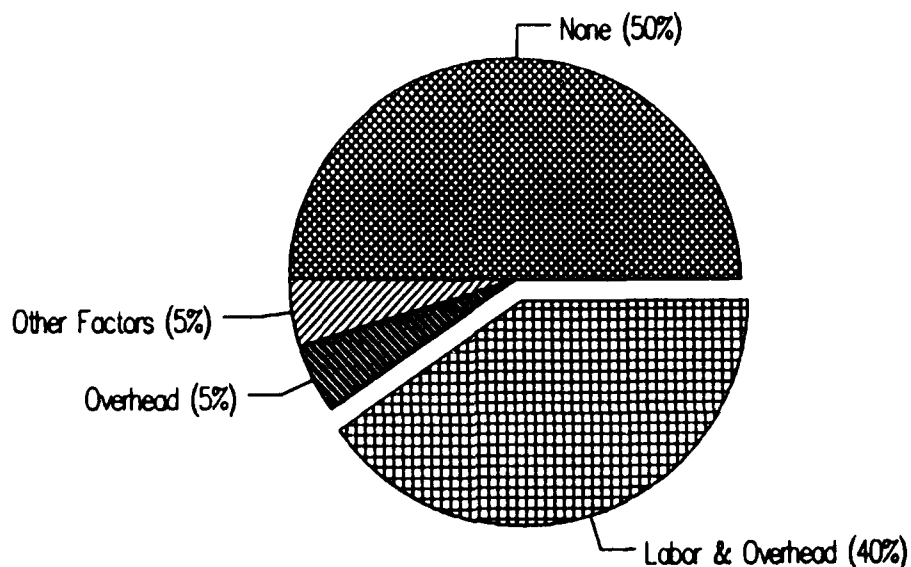


Figure 2. DCASPRO FPRA Usage

Four of the ten DCASPRO's that do not have current agreements are presently reviewing FPRA proposals. Of the four, three are optimistic that they will be able to negotiate some type of FPRA. If all three are successful in establishing an agreement it would increase the percentage of DCASPRO's with current FPRA's from 50 to 65 percent. In

addition, the DCASPRO with the agreement that covers only other factors is reviewing an FPRA proposal on labor and overhead rates. The DCASPRO is optimistic that it will be able to expand its current agreement to encompass these two major categories of rates.

b. NAVPRO

Of the eight NAVPRO's that were surveyed, five (63 percent) currently have FPRA's of some type. Two NAVPRO's (25 percent) have FPRA's covering the major categories of labor and overhead. Both agreements also include other factors. One NAVPRO (12 percent) has an FPRA that covers overhead rates. The agreement does not cover labor rates but does include other factors. Two NAVPRO's (25 percent) have FPRA's that are limited to other factors only. Three NAVPRO's (38 percent) do not currently have any FPRA's. There are no NAVPRO's that have FPRA proposals under review. See Figure 3.

c. Combined Survey Results

The combined survey results of DCASPRO's and NAVPRO's are as follows (See Figure 4):

1. Ten (36 percent) of the 28 activities have current FPRA's covering the major categories of labor and overhead.
2. Two (seven percent) of the 28 activities have current FPRA's covering overhead rates.
3. Three (11 percent) of the 28 activities have current FPRA's covering other factors only.

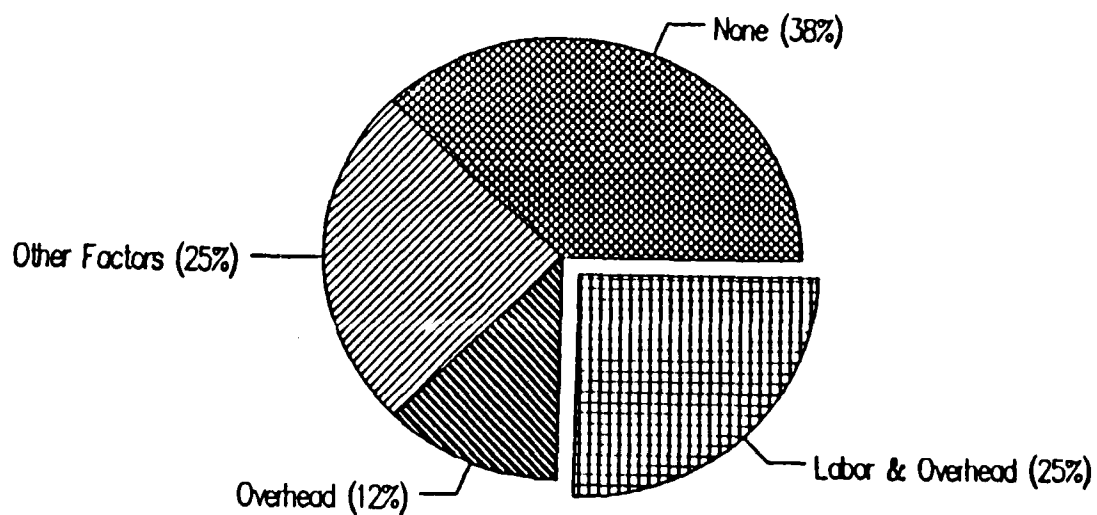


Figure 3. NAVPRO FPRA Usage

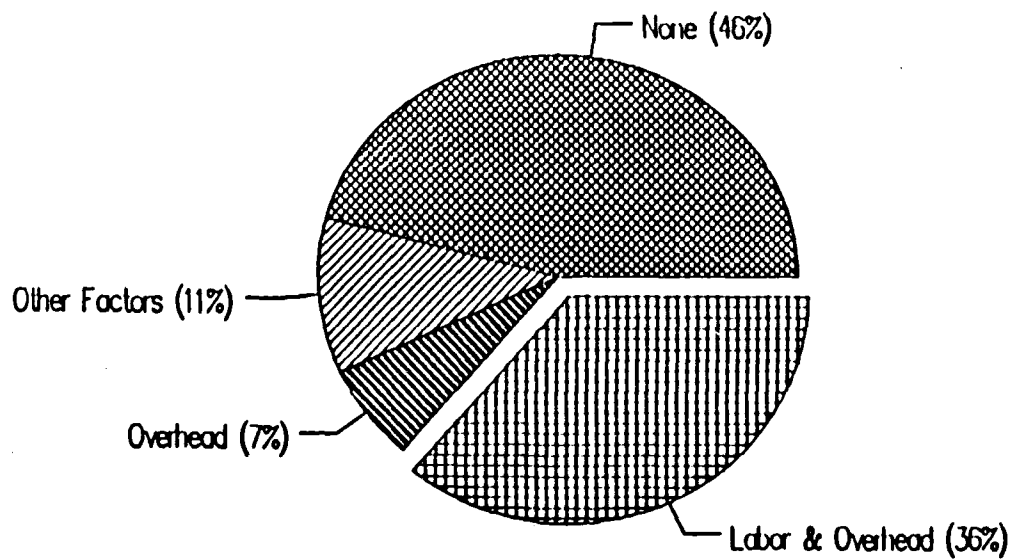


Figure 4. Combined DCASPRO and NAVPRO FPRA Usage

4. Thirteen (46 percent) of the 28 activities have no current FPRA's.

Five activities have FPRA proposals of some type under review. Four are reviewing proposals to reestablish expired agreements and one is reviewing a proposal to add labor and overhead rates to its current agreement that covers other factors. Three of the four commands reviewing reestablishment proposals and the one reviewing the expansion proposal are all optimistic that they will be able to negotiate an agreement. If the four PRO's are successful, the combined number of DCASPRO's and NAVPRO's surveyed that possess FPRA's would rise from 54 to 64 percent. However, commands with agreements covering the major categories of labor and overhead would only rise from 36 to 50 percent.

The 15 commands that responded "Yes" to Question One were asked the subsidiary question: "What is the time period of coverage for the agreement(s)?"

The length of the FPRA's that are currently in effect at the DCASPRO's and NAVPRO's range from one to six years. The most common lengths are annual, three year and five year. It should be noted that the FAR does not mandate that FPRA's cover a specified amount of time.

A breakdown of the periods of coverage for the 15 Plant Representative Offices with current FPRA's is contained in Table 1.

TABLE 1
FPRA PERIOD OF COVERAGE

<u>FPRA Period Coverage</u>	<u>Number of PRO's</u>
One year	3
Two years	1
Three years	4
Four years	1
Five years	2
Six years	1
Three and five years (depending on rate)	2
Until circumstances change	1

The FPRA's that cover a period greater than one year are normally updated annually in order to ensure that the rates covered by the agreement remain current. However, an agreement may be revised more often, if required, due to a change in conditions affecting the rates.

The 13 commands that answered "No" to Question One were asked the subsidiary question, "What are the reasons for not having any agreements?"

There were seven primary reasons given why the 13 activities were unable to negotiate any type of FPRA. The reasons expressed were as follows:

1. Structural reorganization within the company--three of 13 (23 percent).
2. Reluctance/lack of interest on the part of the contractor--two of 13 (15 percent).
3. Sale or pending sale of the company--two of 13 (15 percent).

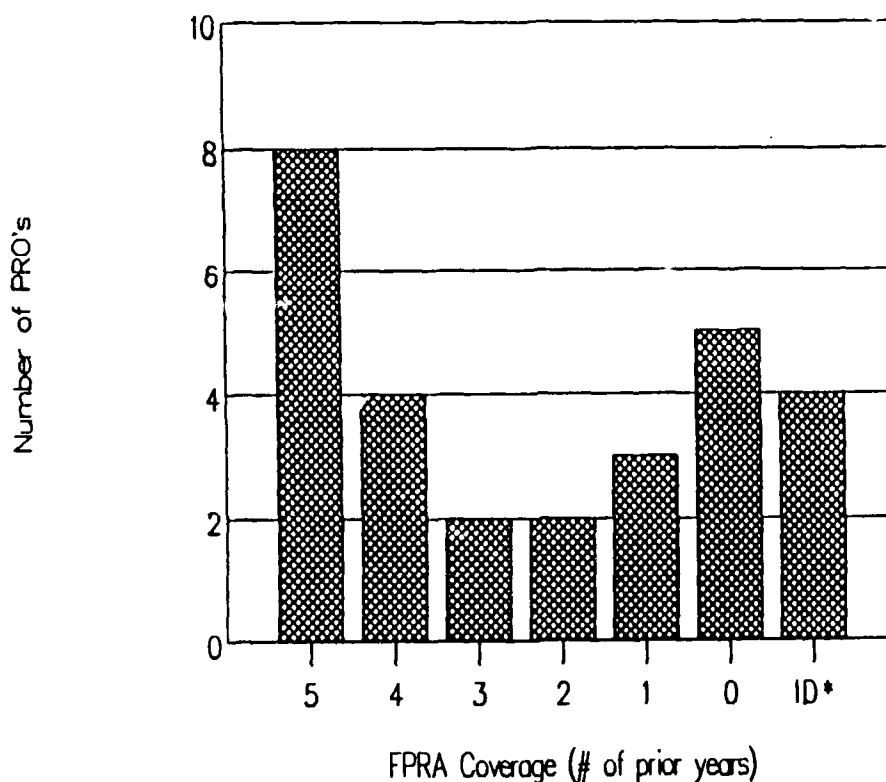
4. Inadequate accounting system and/or cost estimating system--two of 13 (15 percent).
5. Contract type--All or primarily all of the contractor's contracts are Firm-Fixed Price (FFP)--two of 13 (15 percent).
6. Frequent rate changes--one of 13 (8 percent).
7. Currently negotiating a new agreement. The previous FPRA has expired--one of 13 (8 percent).

3. Question Two

Question two was, "Has your office had any FPRA's within the previous five years (calendar years 1983-1987)?"

Twenty-three of the 28 Plant Representative Offices surveyed (82 percent) indicated that their office had negotiated FPRA's of some type within the past five years. Four of these 23 activities were unable to provide data on more than the previous two years but all four did state that their command has executed at least one FPRA within the past two years. A breakdown of historical FPRA usage by all 28 activities according to the number of years that an FPRA was in effect between 1983 and 1987 follows. See Figure 5.

1. Five years out of five--eight PRO's (4 DCAS, 4 NAV)--29 percent.
2. Four years out of five--four PRO's (4 DCAS)--14 percent.
3. Three years out of five--two PRO's (2 DCAS)--7 percent.
4. Two years out of five--two PRO's (1 DCAS, 1 NAV)--7 percent.
5. One year out of five--three PRO's (1 DCAS, 2 NAV)--11 percent.



* Note: ID = Insufficient Data (Data For Past 2 Years Only)

Figure 5. Historical FPRA Usage (Five Year)

6. None--no FPRA's within past five years--five PRO's (5 DCAS)--18 percent.
7. Insufficient data--four PRO's (3 DCAS, 1 NAV)--14 percent.

The 23 commands that responded "Yes" to Question Two were asked the subsidiary question: "Were any of the prior agreements abrogated and if so, for what reason or reasons?"

Of the 23 activities that had FPRA's during the past five years, 16 (70 percent) stated that at least one agreement had been abrogated. The overwhelming reason given

for why the agreements were canceled was "the overrunning or underrunning of the negotiated rates." This reason was cited by 14 of the 16 respondents as being at least one of the reasons for abrogation. Two other reasons indicated were "Cost Accounting Standards (CAS) issues" and the "development of a poor business relationship between the contractor and the Government." The other seven PRO's did not have any of their prior agreements abrogated.

The five commands that responded "No" to Question Two were asked the subsidiary question: "What were the reason or reasons for not entering into any FPRA's?"

Each of the five commands is one of the 13 activities that presently do not have any type of FPRA. Four of the five stated that the reasons they were unable to enter into any agreements in the past are the same reasons they do not have a current agreement: contract type--all FFP (two), frequent rate changes (one) and reluctance on the part of the contractor (one). The respondent surveyed at the other PRO stated that "a poor Government/contractor business relationship" was the reason for the command's inability to negotiate any prior agreements. The respondent indicated that although the business relationship has improved, the pending sale of the company is the reason that there is no current FPRA.

4. Question Three

Question Three was, "What do you feel are the main advantages of FPRA's?"

The main advantage of FPRA's cited most frequently by the respondents was that the agreements "facilitate the review of contractor proposals by the PCO." Twelve of the 28 activities (43 percent) interviewed listed this as at least one of the advantages of FPRA's. The second most popular advantage identified was that FPRA's "simplify and/or expedite the negotiation process." This advantage was stated by eight respondents (29 percent). A third benefit, mentioned by five commands (18 percent), was that FPRA's provide "uniformity and consistency in rates."

A list of other advantages of FPRA's given by those interviewed follows:

1. The FPRA process provides for a greater depth of analysis into contractor's actual costs and cost estimating systems.
2. FPRA's reenforce the "one-face-to-industry" concept of contract administration.
3. FPRA's provide a benchmark with which to measure the contractor's performance.
4. FPRA's help contractors budget and provide the contractor with an incentive to control costs.
5. FPRA's build an atmosphere of cooperation between the Government and the contractor.
6. FPRA's are less costly than a full review of every proposal.
7. PCO's are not relegated to using only DCAA recommended rates.

5. Question Four

Question Four was, "What do you feel are the main disadvantages of FPRA's?"

Thirteen of 28 respondents (46 percent) felt that there were no significant disadvantages if a properly negotiated FPRA was achieved. The most common disadvantage cited by six of the respondents (22 percent) was the possibility of "experienced actual costs getting out of tolerance with the FPRA rates."

Other disadvantages of FPRA's identified by those interviewed are as follows:

1. The complexity of the FPRA process makes it difficult to negotiate the agreement on time.
2. While FPRA's can facilitate a PCO's workload, the agreements can also "tie-their-hands."
3. FPRA's require a vast amount of resources and time to establish and survey.
4. FPRA's are sometimes established when the rate structure is not stable enough to support the rates.
5. The complexity of the FPRA process makes it difficult to quickly establish new rates when rates are abrogated.

6. Question Five

Question Five was, "What actions can be taken by DCASPRO'S/NAVPRO'S to increase the number of FPRA's?"

Three actions were cited by more than one of the activities in answer to this question. The required use of the "Joint Logistics Commanders' (JLC) rates for executive compensation, salaries, wages and employee benefits" was

mentioned by 15 respondents (54 percent) as an obstacle that, if removed, would lead to an increase in the number of FPRA's. As discussed in Section II.B.2.c., there are five PRO's that have current FPRA's where the agreements do not cover labor rates. All five stated that the JLC rate requirement was the primary reason why they were unable to negotiate an FPRA that included labor rates. Five of 28 commands (18 percent) felt that "the Government needs to do a better selling job to the contractor." They stated that the DCASPRO's/NAVPRO's must educate the contractor to the benefits of FPRA's and emphasize the importance of the agreements. Three respondents (11 percent) said that "pressure on the contractors from the buying offices to enter into FPRA's would motivate some contractors into negotiating agreements."

In addition to the three actions described above, other actions that were identified are as follows:

1. Use of unilaterally determined Forward Pricing Rate Recommendations (FPRR's) to motivate the contractor to enter into a bilateral FPRA.
2. Development of a better working relationship and rapport among the three organizations involved in the FPRA process--the PRO, DCAA and the contractor.
3. Negotiate individual factors. Do not hold out for an all or nothing agreement.
4. Review FPRA proposals with the intent of entering into an agreement.
5. Use of a Business Management Office concept similar to the Air Force Plant Representative Offices (AFPRO'S) where one office is responsible for all aspects of the FPRA.

6. Require contractors to submit FPRA proposals on a timely basis.
7. Reward contractors that establish FPRA's.

7. Question Six

Question Six was, "What actions can be taken by government contractors to increase the number of FPRA's?"

It was the general consensus of those interviewed that "contractors are only going to enter into FPRA's if they feel that an agreement is in their best interest." For contractors truly interested in establishing an agreement, "cooperation," "good communications" and "timely submission of current, accurate and complete proposals" were the actions identified as being most beneficial towards increasing the number of FPRA's. One or a combination of all three of these actions were mentioned by 12 of the respondents (43 percent). Other actions stated are as follows:

1. Contractors must have an accounting system capable of supporting an FPRA.
2. In some cases contractors need to propose a greater number of factors.
3. In some cases contractors need the interest and involvement of higher levels of management in the FPRA process.

8. Question Seven

Question Seven was, "What statutory or regulatory changes could be made that would lead to an increase in the number of FPRA's?"

An overwhelming majority of the respondents (19 PRO's (68 percent)), expressed satisfaction with the current laws and regulations governing FPRA's and felt that no statutory or regulatory changes should be made. Although not specifically a regulation, there was considerable discussion on the issue of the JLC rates. Those PRO's that are impacted by the use of these rates found them to be unrealistic and said the 3.5% should be changed or the requirement to use the rates abolished. A representative sample of the comments expressed by DCASPRO/NAVPRO personnel concerning the JLC uniform rates of change follows:

1. We should do away with the tri-services (JLC) or DRI. You cannot live with both of them. DCAA uses DRI and they take into consideration the tri-services....If the audit report uses DRI, and the contractor is aware of this, how will you ever get to tri-services if it is lower? I think that they (JLC's) are playing games.
2. We had a negotiated agreement until October 1986. Then the company sat down and negotiated with the union and that negated our FPRA's for obvious reasons--the factors were no longer valid. We're stuck with 3.5%. It's been a horrendous chore to try and get anything done with the contractor because of that.
3. The only problem is right now we're stuck with a mandated 3.5% rate that is an unrealistic rate. I've talked unofficially to the contractor about the 3.5%. They are just backing in the hours to come out to the bottom line in order to get what they feel is a reasonable rate.
4. The JLC rate is illogical, impractical, and such a vague guideline that its quite useless because there are seldom two contractors that are alike.

Other recommended statutory/regulatory changes follow:

1. A change to the regulations that would allow for unilateral adjustment of the rates based on trend data accumulated by the cost monitor.
2. Establish a mandatory requirement for PCO's to use FPRA's.
3. Make a change to the Weighted Guidelines Method of profit/fee determination to reward contractors for their use of FPRA's.

C. SUMMARY

The purpose of Chapter III was to provide the results of the survey that was conducted of the 28 DCASPRO's and NAVPRO's. The chapter was segmented to address the data of each survey question separately. An analysis of this data will be contained in Chapter IV.

IV. DATA ANALYSIS

A. INTRODUCTION

The first step in the analysis will be to examine the advantages and disadvantages of FPRA's in order to determine the usefulness of these agreements as a tool in the contracting process. The extent to which FPRA's have been established by DCASPRO's and NAVPRO's should reflect this usefulness.

The analysis is divided into three sections. Section one will examine the advantages and disadvantages of FPRA's. Section two will review current FPRA usage at the DCASPRO's and NAVPRO's. Section two will also analyze the reasons why FPRA's are not established and discuss some actions that may be taken in order to increase the number of agreements. Proposed statutory/regulatory changes are presented in section three.

B. ANALYSIS

1. Advantages and Disadvantages of Forward Pricing Rate Agreements

a. Advantages

A PCO who does not have forward pricing rate agreements or recommended rates available for use must attempt to negotiate contracts from positions based primarily on DCAA audited rates. Without an FPRA or FPRR it

is difficult for the PCO to determine a fair and reasonable price, particularly if he/she is getting adverse opinions from the auditor. Conversely, the contractor is at an advantage in this situation because the PCO has neither the time nor the resources to digest the contractor's entire accounting system and examine all the details of every rate. It is hard for the PCO to identify what problems are present in the contractor's overheads.

However, when an FPRA is in place, the majority of a PCO's contract proposal analysis has already been accomplished. The PCO receives the primary benefits of the time and effort that have already been expended by DCAA and the Contract Administration Office (CAO) in establishing the forward pricing rate agreement. The PCO is able to substantially reduce his/her own workload by using FPRA's in cost analysis. The PCO has rates available that have been reviewed by both DCAA and the CAO and have been determined to be fair and reasonable by both the contractor and the Government. All the PCO must do in the proposal evaluation is validate the quantities and kinds of labor and material. Once the validation is complete the PCO can use the FPRA as a price schedule and price out the contract.

The Government also gains an in-depth knowledge and understanding of the contractor's accounting and cost estimating systems through establishment of an agreement. The FPRA proposal review equates to a mini should cost (if

the review was not done in conjunction with an actual should cost). Should cost techniques are used to evaluate overhead rates and every element of the pools is examined. This FPRA proposal review is a very time consuming, labor intensive process but it pays off through the knowledge that is gained of the contractor's business practices.

FPRA's are also useful to the contractor. The agreements simplify preparation of contract proposals. They can be used as a management tool to control costs. Management can give the negotiated rates to the program managers and/or department heads and say "Here are the negotiated rates that you need to meet." The FPRA rates thus become goals for the middle managers to achieve.

b. Disadvantages

The disadvantage of FPRA's mentioned most frequently by the respondents was the possibility of "experienced actual costs getting out of tolerance with the FPRA rates." When this circumstance occurs and the FPRA rates are not modified or abrogated, one of the parties to the agreement could suffer.

On a Firm Fixed Price (FFP) contract, the contractor assumes all of the contract cost risk. If actual costs get out of tolerance with the FPRA rates on which the FFP contract was based, the contractor will either gain or lose money. This is an inherent risk with an FFP contract whether the contract is established using rates negotiated

separately or using an FPRA. If the contractor is overrunning the rates the contractor is losing money. If the rates are being underrun the contractor will be making additional profits. Due to the nature of an FFP contract, when a proposal is priced using FPRA rates, the PCO must ensure that the FPRA is still current and accurately reflects the contractor's rates before entering into this type of contract.

If actual costs and FPRA rates get out of tolerance on cost type or flexibly priced contracts, there is less of a potential monetary gain or loss providing that provisional billing rates are properly adjusted. However, if the billing rates are not being properly maintained, overrunning cost type or flexible priced contracts could cause a contractor serious cash flow problems. A contractor that underruns will be gaining interest free use of the Government's money until the time when the final rates are determined.

The negotiation of FPRA's must not be viewed as a win or lose contest. The focus should be on obtaining rates that are fair and reasonable to both sides. The execution of an agreement with rates that are lower than estimated appears appealing to the Government. However, an agreement of this type would actually be a disadvantage. When billing rates are determined or the final rates are established "a few years down the road," the PCO's who have

entered into cost type or flexibly priced contracts using FPRA rates that are too low may be required to find additional funding to cover the differences between the FPRA rates and the billing or final rates.

The CAO must use good business judgement in establishing an FPRA. An FPRA should not be executed for the sole purpose of having a rate agreement. If there is instability in the contractor's rate structure, it is not in the Government's best interest to commit the time and resources required for an FPRA because there is no guarantee or assurance that the rates are going to stand for a reasonable period of time. It would be disadvantageous to enter into an FPRA under these conditions.

c. Summary

Based on both research and the interviews conducted with the survey respondents, it is apparent that in most cases the advantages of FPRA's heavily outweigh the disadvantages. This is supported by the fact that 46 percent of the respondents could not identify any disadvantages of a properly negotiated agreement. An exception to this is when there is instability in the contractor's rate structure. As was discussed above, there is much to be gained by establishing an FPRA. An agreement both facilitates the performance of a contracting officer's workload and provides the Government with an in-depth knowledge of the contractor's accounting and cost estimating

systems. This more than offsets the small possibility of establishing rates that do not reflect actual costs. (Even if improper rates are established, they are easily abrogated.) Therefore, it becomes obvious that FPRA's are beneficial.

There is a very high level of satisfaction concerning FPRA's among those activities with current agreements. Additionally, the majority of commands without FPRA's expressed a desire to have them. Since a comparison of FPRA advantages to disadvantages shows that the agreements are beneficial in most circumstances, the question arises: "Have FPRA's been established to the maximum extent possible?" The next section will examine FPRA usage at the DCASPRO's and NAVPRO's.

2. Forward Pricing Rate Agreement (FPRA) Usage

The primary research question of this thesis concerns the extent to which FPRA's have been established at DCASPRO's and NAVPRO's. A recapitulation of the data shows that approximately one-half (54 percent) of the commands surveyed currently have agreements of some type while only about one-third (36 percent) have agreements covering the major categories of labor and overhead. These percentages could rise to 64 percent and 50 percent, respectively, depending on the outcome of FPRA proposals that are presently under review.

As discussed in the previous section, the advantages of FPRA's vastly outweigh the disadvantages. Thus, it is the researcher's opinion that the percentage of activities with agreements is too low for a contracting tool as beneficial as an FPRA. This is particularly true for the number of commands with FPRA's covering both labor and overhead rates. In the most optimistic outcome only 50 percent of the activities would possess agreements covering these two categories.

In an effort to determine why these percentages are low, the following paragraphs contain an analysis of some of the reasons why PRO's do not have FPRA's of any type or have agreements that are limited in scope. Reasons one through five are the main reasons why FPRA's are not established. The data in Chapter III show that no one of the five are predominant but rather all five have virtually the same impact. Reason six is the primary reason why PRO's are unable to enter into FPRA's that cover labor rates.

a. Reason One--Structural reorganization or sale of the Company

This was the most common reason given for the inability of those activities surveyed to establish an FPRA. Sale and/or reorganization of a company tends to affect each division's strategic and financial plans. Budgets are normally changed and contracts are occasionally shifted between divisions. Manufacturing overhead and G&A bases are frequently affected. During these periods of change there

is reluctance on the part of both the contractor and the Government to enter into any type of forward pricing rate agreement.

It is advisable for both parties to avoid an FPRA during a period of reorganization or sale of the company. Either of these circumstances can lead to instability in the contractor's rates. When there is instability in the rates an FPRA is no longer useful. The Government has no control over the sale or reorganization of a company but it is incumbent upon the CAO to attempt to establish new agreements once the sale or reorganization of the company is complete.

b. Reason Two--Contract Type

Two contractors did not desire to enter into FPRA's because they bid rates competitively and bid only on Firm Fixed Price (FFP) contracts. It is the researcher's opinion that the contractors' decision is justified. One of the characteristics of FFP contracts is that contractors assume all cost risk. If the contractors bid only on Invitations For Bid (IFB) under the sealed bid method of contracting it is not in their best interests to have established forward pricing rates.

c. Reason Three--Frequent Rate Changes

A contractor who bids on a high volume of contracts in a competitive marketplace is subject to a frequently changing business base. Overhead rates may

fluctuate significantly depending on how successful the contractor is in obtaining new work. Frequently changing business conditions can cause a contractor's rates to change periodically throughout the year. In this case, an FPRA is not cost effective because the time, effort and costs required to initially attain the agreement are wasted if the agreement is abrogated shortly after execution. Frequent updating and continual negotiations would be required to maintain an FPRA. Therefore, it can be concluded that when a contractor's rates change frequently throughout the year, an FPRA is not desirable.

d. Reason Four--Inadequate Accounting System
and/or Inadequate Cost Estimating System

Contractors with inadequate accounting systems and/or inadequate cost estimating systems are lacking the fundamentals required to establish an FPRA. If the cost estimating systems are inadequate, it is not possible for the contractor to submit a proposal that can be determined to be fair and reasonable by the ACO. Additionally, if the contractor's accounting system is inadequate, an FPRA could not be monitored because variance analyses could not properly be performed.

Pressure must be put on those contractors with inadequate accounting and/or cost estimating systems to improve these systems. This issue transcends FPRA's. It is important for any contractor that does a significant volume

of Government business to have adequate accounting and cost estimating systems.

e. Reason Five--Contractor is Reluctant to Enter into an FPRA

There are certain instances where the contractor just simply does not desire to have an FPRA. One reason is the contractor's lack of knowledge of the advantages of this type of agreement. Some contractors also feel that the Bid and Proposal (B&P) costs required to establish an FPRA are too large an investment in an agreement that has the possibility of being canceled before it expires.

Contractors who are reluctant or lack interest can only be convinced to enter into FPRA's through proper selling of the agreements. Contractors need to be persuaded that some up-front work can pay off in the long run through reduced proposal preparation effort and simpler negotiations. However, convincing a contractor of the benefits of FPRA's is not the sole responsibility of the CAO. Pressure to establish an FPRA must be put on the contractor by the actual customers, the PCO's.

In order for the Government "to sell" FPRA's, contractors must be willing to establish FPRA's. DCASPRO's/NAVPRO's need to review FPRA proposals with the objective of reaching an agreement. The contractor's top management must understand that it is the Government's desire to come to an agreement. A contractor who feels that the DCASPRO/NAVPRO is attempting to establish an agreement that is fair and

reasonable, vice one-sided or punitive, will be more receptive to the idea of an FPRA. The PRO's and their cognizant contractors must maintain a cooperative business atmosphere.

Maintaining a cooperative relationship also requires the contractor to submit timely FPRA proposals. The proposals must be current, accurate and complete and the contractor must also have accounting and cost estimating systems that are capable of supporting the proposal. If the proposals are not current, accurate and complete, or the contractor cannot support them, the Government will waste time and effort reviewing the proposal. The cooperative business atmosphere will then deteriorate. The same holds true if the Government does not attempt to negotiate a fair and reasonable agreement. The contractor will begin to distrust the Government and it will be impossible to reach any type of agreement.

A program to reward contractors that establish FPRA's is another action that could overcome the reluctance of a contractor to enter into these agreements. Although some contractors do not view FPRA's as equitable, a reward such as increased profit or fee, or less Government oversight might provide the proper incentive for a previously reticent contractor to execute an FPRA.

One way to reward contractors who establish FPRA's is a change to the Weighted Guidelines Method of

profit/fee determination. This could be accomplished by adding another section to the Weighted Guidelines that would allow for an additional percentage of profit/fee, (e.g., one percent) if FPRA rates are used in proposal evaluation. Another way to reward contractors would be to permit profit/fee on Bid and Proposal (B&P) costs that were incurred on FPRA's. However, it would be very difficult to properly apportion this allowance over the contractor's various contracts.

The researcher feels that both of these proposed reward systems have merit. Additional profit can be a strong motivator for some contractors, but less Government oversight may be all that is needed for a contractor to establish an agreement. Contractors are very dissatisfied with the amount of Government audit and review that they are subject to. Any action that would lessen this burden would be desirable to most contractors and thus be considered a reward.

On the other hand, some contractors may be reluctant to enter into an agreement regardless of the reward. The FPRA review process permits the Government to gain an in-depth knowledge of the contractors' records and business practices. These contractors do not want the Government to have this level of understanding of how they conduct their business.

f. Reason Six--The JLC Uniform Rates of Change for Executive Compensation, Salaries, Wages and Employee Benefits

It is difficult to expect that one escalation rate, such as the JLC rate, can be established that is appropriate for all contractors. Geographical location, nature of business, size of business, and type and size of contracts are some of the factors that affect a contractor's work force and labor rates. Some contractors have a blend of very sophisticated personnel (e.g., engineers, scientists, systems analysts) while other contractors use predominantly blue collar workers. Data Resources, Inc. (DRI) indices reflect these various factors but the JLC rates of change do not. Even DCAA used DRI factors when computing costs.

During discussions with both DCASPRO and NAVPRO personnel the researcher gained the impression that, depending upon the PRO's customers, it is much easier for a DCASPRO to establish an FPRA covering labor rates than it is for a NAVPRO. This is because the Navy seems intent on making the JLC rates a cap while the Air Force and Army are willing to accept a higher rate if properly justified. Therefore, the NAVPRO's find it impossible to justify a higher rate while a DCASPRO, depending on who is its primary customer (Air Force, Navy or Army), can more easily justify a rate higher than JLC and establish an FPRA. Both the Navy and DLA have directed that JLC rates be used by the PRO's

for labor escalation unless a higher rate is justified (Section II.H.1). DCASPRO's that have the backing of their buying commands, normally the Air Force and ARMY, have been more successful in justifying labor rate increases higher than JLC and establishing FPRA's covering labor. Although buying command approval is not required to execute an FPRA, it is a waste of effort to establish agreements that will not be used by the PCO's. This is why the NAVPRO's and DCASPRO's that have the Navy as primary customers have not been very successful in establishing FPRA's that cover labor rates.

There are two other reasons why the DCASPRO's and NAVPRO's are able to establish FPRA's for labor without exceeding the JLC 3.5 percent rate. These two occur when a contractor uses either (1) union agreements which call for a less than 3.5% rate of change or (2) a merit (bonus) pay system. Merit pay is a system where employees are paid lump sum bonuses above their base salary. The base salary remains constant from year to year and thus does not reflect an annual escalation. Merit pay is very controversial; however, the overall net effect over several years is normally less than a 3.5 percent annual escalation because there is no annual compounding of the escalation.

There is currently a decline in the usage of FPRA's at the DCASPRO's and NAVPRO's. This decline appears to be due more to the existence of factors that make FPRA's

difficult to establish rather than dissatisfaction with the agreements. Structural reorganization or sale of the company; inadequate accounting system and/or cost estimating system; and reluctance/lack of interest on the part of the contractor are the main reasons for the decline. Each of these reasons was previously discussed.

3. Laws and Regulations Governing Forward Pricing Rate Agreements

As stated in Chapter III, the majority of the respondents felt that the current laws and regulations governing FPRA's are satisfactory and should not be changed. The researcher agrees with this position. The fact that an FPRA is a voluntary agreement as opposed to a requirement is one of its main selling points. Since neither the Government nor industry are obligated to establish FPRA's, they will negotiate agreements only when it is in their best interests. Therefore, an FPRA is an agreement between the Government and a contractor that represents the best interests of both parties. Although the current laws and regulations are satisfactory, the following proposed changes may enhance FPRA's.

One possible change to the regulations is a requirement for PCO's to use FPRA's once they have been established. If PCO's do not use the agreements but attempt to negotiate rates on each new contract proposal they are undermining the whole purpose of FPRA's. A PCO's non-use of an effective agreement gives the contractor an impression

that the time and effort spent by the contractor in establishing the FPRA was wasted. It will probably make the contractor reluctant to enter into rate agreements in the future. If an FPRA is no longer current, the ACO must modify the rates or abrogate the agreement. However, if the FPRA is current, PCO's should be required to use the agreed to rates in contract proposal evaluations.

Another recommended change to the regulations is an allowance for unilateral adjustment of the rates based on trend data accumulated by a cost monitor. Currently it is standard procedure to wait until the rates get out of tolerance and then either modify the agreement or abrogate and attempt to establish a new agreement. Both of these options are labor intensive because new proposals must be submitted and reviewed and negotiations must take place. Monthly or quarterly unilateral adjustment of the rates based on trend data will ensure that the rates remain current with a minimal expenditure of time and effort. The contractor still has the option to abrogate the agreement if the unilateral change is not deemed to be fair and reasonable. Although this process is more practical for billing rates than for FPRA's, if forward pricing rates are frequently adjusted based on trend data, it might be possible to reduce the number of agreements that are abrogated.

C. SUMMARY

A review of the advantages and disadvantages of FPRA's showed that these agreements, when properly negotiated, are an effective contracting tool. An examination of their usage revealed that FPRA's have not been established to the maximum extent possible at DCASPRO's and NAVPRO's. The reasons for non-use and proposed solutions were discussed in this chapter. Some proposed statutory/regulatory changes that might improve the agreements were also examined. The final chapter of this thesis will address the researcher's conclusions and recommendations concerning FPRA's. Chapter V will answer the research questions and suggest topics for further research.

V. CONCLUSIONS AND RECOMMENDATIONS

A. INTRODUCTION

Data presented in this thesis were derived from an examination of Forward Pricing Rate Agreements at NAVPRO's and DCASPRO's. This final chapter will state the researcher's conclusions as derived from analysis of these data. The chapter will also include recommendations for improving the FPRA process, answer the research questions, and list areas of possible future research on this topic.

B. CONCLUSIONS

1. Forward Pricing Rate Agreements Covering the Main Categories of Labor and Overhead Rates Have not Been Established to the Maximum Extent Possible at DCASPRO's and NAVPRO's

Only 36 percent (10 of 28) of the activities queried have agreements that cover the major rates of labor and overhead. Of these 10 PRO's, only nine have agreements which also cover other factors.

There are five commands that are presently reviewing FPRA proposals. Four of the five commands are optimistic that they will be able to negotiate agreements which cover both labor and overhead rates. However, even if all four PRO's are successful, the percentage of DCASPRO's and NAVPRO's that have FPRA's covering the major categories of labor and overhead would only rise to 50 percent.

2. The Joint Logistics Commanders' (JLC) Uniform Rates of Change are Currently the Primary Obstacles Preventing an Increase in the Number of FPRA's Which Cover Labor Rates

All five activities that possess current FPRA's which do not cover labor rates cited the JLC uniform rates of change for executive compensation, salaries, wages and employee benefits as the reason why they were not able to include labor rates in their agreements. Fifty-four percent of the respondents mentioned the JLC rates as an obstacle that, if removed, would lead to an increase in the number of FPRA's.

3. The Laws and Regulations Governing FPRA's are Satisfactory and do not Currently Require Any Changes

The survey data showed that, overall, there is general satisfaction with the laws and regulations governing FPRA's. Sixty-eight percent of the respondents felt that no statutory or regulatory change should be made concerning these agreements. The researcher agrees with that opinion.

4. The Overrunning or Underrunning of the Agreement Rates are the Primary Reasons FPRA's are Abrogated (Canceled)

Eighty-eight percent (14 of 16) of the commands that have abrogated a previous FPRA stated that overrunning or underrunning of the rates was the primary reason. When changes in a contractor's business conditions cause the rates to get out of tolerance, the contractor will, depending on the direction the rate changes, begin overrunning or underrunning the rates. When this occurs, an

FPRA is no longer an effective means for pricing contracts and thus it is proper to abrogate the agreement. This is the reason FPRA rates are monitored on a continual basis.

5. There is Presently a Decline in the Establishment of FPRA's at DCASPRO's and NAVPRO's

Although forty-six (13 of 28) of the commands surveyed currently do not have FPRA's of any type, only 18 percent have not had any agreements in the past five years. As was previously stated in Chapter IV, the decline appears to be due more to the external imposition of factors that make FPRA's difficult to establish rather than dissatisfaction with this type of agreement.

6. In Most Cases, the Advantages to the Government of FPRA's Heavily Outweigh the Disadvantages of the Agreements

For the Government, there is much to be gained and little to be lost in establishing an FPRA. Forty-six percent of the survey respondents could not identify any disadvantages of a properly negotiated FPRA. The agreement both facilitates the performance of a contracting officer's workload and provides the Government with an in-depth knowledge of a contractor's accounting and cost estimating systems. The main exception to this conclusion is when there is instability in the contractor's rate structure.

7. FPRA's that are Current and in Effect are not Always Utilized by Procurement Contracting Officers (PCO's) for Contract Proposal Evaluations

FAR states that: "Contracting Officers will use FPRA rates as bases for pricing all contracts, modifications

and other contractual actions...." [Ref. 1:p. 15-39]
However, it was the experience of the majority of the survey respondents that the rates are normally, but not always, used by PCO's. There are two primary reasons for non-use of the agreement rates. Either the PCO's are not aware that an FPRA exists or the PCO's feel that they can negotiate rates that are better than the agreement rates.

C. RECOMMENDATIONS

1. Eliminate the Requirement to use the JLC Uniform Rates of Change When Determining Forward Pricing Rates for Executive Compensation, Salaries, Wages and Employee Benefits

During the course of the survey it became evident that there was a strong dissatisfaction among the respondents regarding the requirement to use the JLC uniform rates of change. It also became evident that the required use of these rates was the main reason why FPRA's covering all factors could not be established.

Most contractors view the JLC rates as unrealistic. However, most contractors are willing to use Data Resources, Inc. (DRI), indices for forecasting labor escalation. DCAA also recommends using DRI rates. A replacement of the requirement to use JLC rates with the requirement to use DRI rates would result in an increase in the number of FPRA's which cover labor rates.

2. Establish Some Type of Reward System for Contractors Who Enter into FPRA's

Some contractors do not view FPRA's as equitable and thus do not desire to enter into this type of agreement. The contractor's feelings are justified. On the whole, FPRA's are more beneficial for the Government than they are for contractors. Although the proposal process is simplified for both parties, the Government derives an added advantage by obtaining greater visibility into how the contractors conduct their business. Therefore, a reward to contractors who execute FPRA's such as less Government oversight or increased profit or fee would balance this inequality and provide reticent contractors with an incentive to negotiate FPRA's.

3. Both Plant Representative Office and Buying Command Personnel Must Take an Active Role in the FPRA Process and Sell These Agreements to Those Contractors Who are Reluctant to Establish Them

Contractors who are reluctant to establish or lack interest concerning FPRA's can only be convinced to enter into FPRA's through proper selling of the agreements. DCASPRO/NAVPRO personnel must assume an active role in this selling process and persuade contractors that some up-front work can pay off in the long run through reduced proposal preparation effort and simpler negotiations. The actual customers, the buying commands, must also become active in the selling process by putting pressure on contractors to establish agreements.

4. Establish a Mandatory Requirement for Procurement Contracting Officers (PCO's) to Use FPRA's in Contract Proposal Evaluations

When PCO's do not use FPRA's, but attempt to negotiate rates on each new contract proposal, they are undermining the whole purpose of FPRA's. A PCO's non-use of an effective agreement gives the contractor an impression that the time and effort spent by the contractor in establishing the FPRA was wasted. It will probably make the contractor reluctant to enter into rate agreements in the future.

D. ANSWERS TO RESEARCH QUESTIONS

1. Primary Research Question: To What Extent have Forward Pricing Rate Agreements (FPRA's) been Established at DCASPRO's and NAVPRO's?

As shown in Section II.B.2.c., 54 percent of the activities queried currently have FPRA's of some type. Only 36 percent have agreements that cover the major rates of labor and overhead. Of this 36 percent, 90 percent have agreements that also cover other factors. Forty six percent of the activities currently do not have FPRA's of any type.

Eighteen percent of the commands are presently reviewing FPRA proposals to either establish new agreements or increase the coverage of current agreements. Eighty percent of these commands are optimistic that they will be able to negotiate an agreement. If the 80 percent are indeed successful, the combined number of DCASPRO's and NAVPRO's surveyed that possess FPRA's would rise from 54 to

65 percent. However, commands with agreements covering the major categories of labor and overhead would only rise from 36 to 50 percent.

Although data were gathered from only about one-half of the DCASPRO's and NAVPRO's it is assumed that the percentages presented above accurately reflect the entire population.

2. What are the Reasons (Government and Contractor), That FPRA's are not Established?

There are five main reasons why FPRA's are not established and one reason why the Government is unable to enter into agreements that cover labor rates. These six reasons are:

1. There is instability in the rates due to a structural reorganization and/or sale of the company.
2. The contractor bids rates competitively and bids only on Firm Fixed Price (FFP) contracts.
3. Frequent rate changes--The contractor's periodic rate changes throughout the year cause FPRA's to not be cost effective.
4. The contractor's accounting and/or cost estimating systems are inadequate to support an agreement.
5. The contractor is reluctant to enter into an FPRA.
6. The required use of the Joint Logistics Commander's (JLC) uniform rates of change for executive compensation, salaries, wages and employee benefits is the reason why PRO's have been unable to establish FPRA's covering labor rates.

3. To What Extent and for What Reasons are FPRA's Abrogated (Canceled) by Either Party Prior to the Expiration of the Agreement?

As was shown in Chapter III, 82 percent of the activities surveyed have had at least one FPRA during the past five years. Of these activities, 70 percent have had at least one agreement abrogated.

The overwhelming reason why FPRA's are canceled is the overrunning or underrunning of the agreement rates. Cost Accounting Standards (CAS) issues and the development of a poor business relationship between the contractor and the Government are two other reasons.

4. What Actions can be Taken (Government, Contractor and Statutory/regulatory) to Increase the Number of FPRA's?

The primary actions the Government can take to increase the number of FPRA's are: (1) abolish the requirement to use the JLC uniform rates of change for labor rates, (2) do a better job of selling FPRA's to contractors and (3) have the buying offices put pressure on contractors to enter into FPRA's. Cooperation, good communications and timely submission of current, accurate and complete proposals are three actions required of contractors to increase the number of agreements. The laws and regulations currently governing FPRA's are satisfactory and no statutory or regulatory changes are required.

E. TOPICS FOR FURTHER RESEARCH

1. Compare and contrast the method utilized by the Joint Logistics Commanders (JLC) to establish labor escalation rates against the method used by Data Resources, Inc. (DRI). Examine the proposed rates against actual labor escalations experienced to determine which method is more accurate.
2. AFPRO's have established a Business Management Office responsible for all aspects of FPRA's. Compare and contrast this concept with the way in which FPRA's are presently administered at DCASPRO's and NAVPRO's.
3. Examine the use of FPRA's at Defense Contract Administration Services, Management Areas (DCASMA).

LIST OF REFERENCES

1. Federal Acquisition Regulation, 1984.
2. Contract Administration Manual For Contract Administration Services (DLAM 8105), 1984.
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